No. 9985

United States

Circuit Court of Appeals

For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

BRIEF OF APPELLANT

CHARLES M. BUFFORD,
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WEst 1941
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Attorney for Appellant.

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APPELLANT'S BRIEF

JURISDICTIONAL STATEMENT

On February 6, 1941, the debtor filed its verified petition for corporate reorganization, under Ch. X of the Bankruptcy Act, in The Southern Division of the United States District Court for the Northern District of California, and the same was assigned for hearing before Hon. Harold Louderback.

The petition alleged facts showing that the debtor is a corporation; that it has had its principal place of business at San Francisco within said district for more than 6 months immediately preceding the filing of the petition; that it is such a corporation as is authorized to file a petition under Ch. X; that it is unable to pay its debts as they mature, and desires that a plan of reorganization be effected under Ch. X; that no plan of reorganization, adjustment or liquidation affecting the debtor's property is pending, except a forced sale under a power of sale in a mortgage trust deed executed by the debtor.

Thus the district court had jurisdiction of the proceeding under secs. 2, 102, and 128 of the Bankruptcy Act, 11 USC 11, 502 and 528.

The present appeal is from a final decree of the district court, disapproving the plan of corporate reorganization presented by the debtor under Ch. X, and dismissing the proceedings; and from an order of the district court, subsequently made, refusing to amend said decree so as to grant said debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections.

The notice of appeal is supported by an affidavit setting forth that the amount involved in said decree and in said order, each respectively, is in excess of $500.

This court has jurisdiction of the appeal under secs. 24a and 121 of the Bankruptcy Act, 11 USC 47a and 521.

STATEMENT OF THE CASE

From the debtor's schedules accompanying its petition for corporate reorganization, it appeared that the debtor's principal assets were two adjoining parcels of real property, the larger containing about 55,000 sq. feet., or about half the block bounded by Fillmore, Turk, Steiner and Eddy Streets, San Francisco, the smaller containing only about 2,000 sq. ft. The larger parcel was subject to a mortgage trust deed in favor of American Trust Company for upwards of $30,000, the smaller to a mortgage trust deed in favor of Florence B. Brownfield for upwards of $3,000. The debtor's only liabilities, with trifling exceptions, were the obligations so secured. The debtor alleged it possessed a substantial equity in the larger parcel, and, in addition listed other assets valued at more than $2,000.

On Feb. 21, 1941, an order of the district court was filed, approving the petition as properly filed under Ch. X, temporarily continuing the debtor in possession, fixing Apr. 7, 1941, as the time of a hearing to determine whether or not the debtor should be continued in possession thereafter, and Apr. 14, 1941, as the time for the debtor to file a plan of reorganization, and prescribing powers, duties and procedure.

On Apr. 14, 1941, American Trust Company filed its verified answer to the petition.

Therein it alleged that the debtor was indebted to it in excess of $39,114; that the fair market value of the property subject to its mortgage trust deed was far less than the obligations secured thereby; that there is no equity in said property for

the debtor, its creditors, or stockholders; that no plan of reorganization can be effected without the consent of said company; that it has the constitutional right to have the property covered by its trust deed subject to the payment of the indebtedness secured thereby; that the petition was filed for no other purpose than to hinder and delay it in the pursuit of its just rights and remedies; that the debtor has neither the working capital nor equipment necessary to enable it to carry on business as a going concern; that it is impossible for the debtor to be rehabilitated as a going concern; that the debtor is unable to pay his debts as they mature; that the debtor is insolvent; that the debtor's petition was not filed in good faith; that the only businesses which the debtor may lawfully carry on under the provisions of its Articles of Incorporation are the business of a laundry and such other businesses as may be connected therewith or necessary for the operation thereof. The answer admitted that the trustee under said trust deed proposed to sell the property subject thereto for the purpose of satisfying the obligations secured thereby. It prayed that the debtor be not continued in possession, and that the proceedings be dismissed or a trustee appointed.

Neither the debtor's other principal creditor, Florence B. Brownfield, nor any one else, answered.

The issues raised by the answer of American Trust Company were referred to Burton J. Wyman as Special Master, to take testimony and report to the court; and the said Special Master held hearings on the issues thus referred, and the questions in issue were submitted to him for his decision.

Thereafter, on May 31, 1941, the debtor filed with the district court its proposed plan of corporate reorganization.

The crucial provisions of said plan (Rec. pp. 61 to 75) are as follows:

Para. V proposes that the real property subject to American Trust Company's mortgage trust deed be divided into 23 lots, each of 25-foot frontage and desirable depth, 22 of them to face a new public street, 50 feet in width, dedicated and constructed across said parcel, in conformity with a subdivision plat attached to said plan (Rec. p. 75). It also proposes that each lot be improved by the construction thereon of a duplex dwelling with ground-floor garage.

Para. VII(b) provides for the issuance to American Trust Company of a new mortgage trust deed for the principal sum of $29,795.81, being the amount of the principal of its demand, $25,810.52, and of its cash advances, $3,985.29, the same to bear interest at the rate of 4½ per cent per annum, and to cover all property now subject to its demand except said new public street; and for the issuance to American Trust Company of preferred capital stock of the debtor, with absolute priority over its other capital stock, for the residue of its demand, mostly unpaid interest.

Para. V also sets forth: The parcel of real property subject to American Trust Company's trust deed is the largest at present available for a housing development in the entire Fillmore shopping district of San Francisco, and is close to the most desirable residential construction in the district. The duplex dwellings proposed will face their own quiet street. The project will create its own favorable atmosphere, dominate the housing trend in the immediate neighborhood, cater to those who prefer to live closer in town where distances are less and climatic conditions better, and bring a desirable class

of residents and buyers. George E. Ralph as architect, T. D. Harney as street contractor, and Theodore Patrikis as general contractor are ready, willing and able to proceed forthwith, upon the confirmation of the plan, with the construction of the first 6 of said duplex dwellings, the street work, and the installation of utilities.

Para. V further sets forth that the debtor is advised and believes that said duplex dwellings can be constructed for about $6,500 each; but proposed, in view of present increasing construction costs, that the cost be limited to $7,500 each; and the cost of said street work and utilities be limited to $4,000.

Para. IV provides for the issuance by the debtor of non-interest-bearing certificates of indebtedness, to have absolute priority over all other obligations of the debtor, secured and unsecured, to be issued in payment of said building construction and street utility work.

Para. V provides that these certificates be issued against architect's certificates, as the work progresses, in an amount equal to the actual cost of such work, in the customary manner.

Para. V next provides that upon the completion of each unit of said duplexes, the same be sold for cash, at not less than an amount equal to the costs of sale, the cost of construction of the same, plus 1/23 of the cost of street and utility work, plus 1/23 of the principal of the new note to be given American Trust Company; that the balance of such sale price above $1,500, upon each sale, be divided half and half between the contractor's representative and the debtor; that the debtor's share be applied to current taxes, current expenses of operation of the debtor, current interest due American Trust Com-

pany, payments on said new note to be issued to American Trust Company, and redemption of preferred stock to be issued American Trust Company as by said plan provided.

Para. V also provides that as each duplex is sold, the construction of an additional duplex be undertaken on the same terms and conditions, until all said lots shall have been so improved and sold.

Para. VII(a) provides that as the smaller parcel of real property subject to Florence B. Brownfield's mortgage trust deed in no event exceeds in value the amount of her demand, and she has indicated a desire to accept a conveyance thereof by the debtor in full satisfaction of her demand, the said parcel shall be conveyed to her in satisfaction of her demand.

The plan also contains the various miscellaneous provisions appropriate for carrying out the foregoing projects and concludes (Rec. p. 74):

"It is respectfully submitted that the foregoing plan is fair and equitable in all respects, and the debtor respectfully requests all creditors to join in a consent to this plan, so that they, as well as the debtor, will receive the maximum benefits."

Thereafter, American Trust Company filed objections to said proposed plan, on the ground that said plan is unfair and inequitable in each of the following particulars (Rec., pp. 77 and 78):

1. Said debtor is insolvent, and said plan contemplates the realization by the debtor and its stockholders and officers of money, assets, and property of the debtor at the expense of the creditor.

2. Said plan contemplates the creation of a prior encumbrance upon the property hypothecated to the creditor, not-

withstanding the fact that the obligations due from the debtor to the creditor far exceed the value of said property.

3. Said plan discriminates unjustly in favor of Florence B. Brownfield and against American Trust Company, in that it contemplates that the property hypothecated to her be conveyed to her in satisfaction of the obligations owing to her, but contemplates that the property hypothecated to American Trust Company shall be retained by the debtor.

4. Said plan provides for the scaling down of the indebtedness owing to American Trust Company.

5. Said plan contemplates that the assets of the debtor shall be used in a speculative venture for which there is no reasonable prospect of success.

It prayed that said plan be disapproved and the proceedings dismissed or the debtor adjudicated a bankrupt.

Thereafter, an order was made that the issues raised by said objections be referred to Burton J. Wyman as Special Master, to take testimony and report to the court; and in pursuance thereof the Special Master held a hearing on said objections.

At the opening of the hearing counsel for American Trust Company moved to introduce in evidence the testimony adduced on the hearings on the the issues raised by the answer. Debtor's counsel stated he had no objection; but objected to the admission of the testimony of American Trust Company's experts as to the present value of the real estate in its existing condition, on the ground that the proper basis of valuation of the property for the purposes of the plan would be the value as improved and subdivided with duplex structures upon it, and that the existing value of the land is not material. Counsel for American Trust Company urged that the latter is the only

evidence that is material; that the company cannot be compelled to enter into a speculative venture which is entirely dependent on whether or not the debtor can sell the houses for the price it indicates; that, so far as the debtor is concerned, the present value of its assets is far less than the amount of its obligations; that nobody except American Trust Company has any right to vote on said plan; that present value is the only question involved.

The Special Master ruled in accordance with the contention of counsel for American Trust Company, stating that the debtor had to take fixed assets at the present value, otherwise it is speculating on what maybe will happen in the future. (Rec. pp. 85 and 86, 116 and 117.)

The debtor's counsel stipulated to the admission of the testimony adduced on the hearings on the issues raised by the answer, subject to said objection.

At the conclusion of the hearing on the objections of American Trust Company, the matter was submitted to the Special Master.

On July 24, 1941, the Special Master issued his first and only Certificate and Report, wherein and whereby he concluded (Rec., pp. 97 and 98):

"Although there have been hearings on two different matters in connection with this debtor proceeding, I am of the opinion that the court can best deal with the pending questions on the basis of American Trust Company's prayer at the end of its objections that said plan of reorganization be disapproved and that the proceedings be dismissed or debtor adjudicated a bankrupt.

"Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matters of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt.

"I therefore respectfully recommend that the court make one or the other of the aforesaid prayed for orders."

Thereafter the debtor filed with the district court its exceptions to said Certificate and Report (Rec., pp. 100 to 102), wherein and whereby the debtor specified the errors relied upon in this court.

On Sept. 12, 1941, the district court made and filed an order and decree as follows (Rec., pp. 103 and 104):

"The Special Master's Certificate and Report filed July 24, 1941, on the issues raised by the answer of the American Trust Company to the petition for corporate reorganization, having been submitted and fully considered, IT IS ORDERED that the said Special Master's Certificate be and the same is hereby affirmed and the exceptions thereto are hereby overruled. IT IS FURTHER ORDERED that the Plan of Reorganization be and the same is hereby disapproved and these proceedings are hereby dismissed."

On Oct. 13, 1941, the debtor moved the court to amend its said decree so as to grant said debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections, basing said motion on an affidavit filed in the district court Oct. 9, 1941, and the other files and records in the case (Rec., pp. 104 to 108).

On Oct. 22, 1941, the district court entered its order deny-

ing the debtor leave to amend its said plan or file a different plan (Rec., pp. 108 and 109).

The same day the debtor filed its appeal from said decree issued Sept. 12, 1941, and from the whole thereof, and from said order issued Oct. 22, 1941; and its affidavit setting forth that the amount involved in said decree and in said order, each respectively, is in excess of $500.

SPECIFICATION OF ERRORS

The exceptions to the Certificate and Report of the Special Master, heretofore referred to as presented by the appellant to the district court, were that it is erroneous in each of the following respects (Rec., pp. 100 to 102):

1. In finding that the debtor is insolvent.

2. In finding that the plan of reorganization contemplates the realization by the debtor and stockholders and officers of money, assets and property of the debtor at the expense of the creditors.

3. In finding that the plan of reorganization contemplates the creation of a prior encumbrance upon the property hypothecated to the creditors.

4. In finding that the obligations due from the debtor to the creditor exceed the value of the debtor's property.

5. In finding that the plan of reorganization discriminates unjustly in favor of Florence B. Brownfield.

6. In finding that the plan of reorganization provides for the scaling down of the indebtedness owing to the creditor.

7. In finding that the plan of reorganzation contemplates that the assets of the debtor shall be used in a speculative venture.

8. In finding that the plan of reorganization presents no reasonable prospect of success.

9. In that the Special Master at the hearing on the plan of reorganization considered only the present value of the security for the obligation of American Trust Company.

10. In that the Special Master at the hearing refused to consider the subdivided and improved value of the security for said obligation.

11. In that no findings of fact are made therein.

12. In that no findings of fact or conclusions of law or either of them are made with respect to the answer of American Trust Company.

The action of the district court upon such exceptions was as follows (Rec., p. 103):

"It is ordered that the said Special Master's Certificate be and the same is hereby affirmed and the exceptions thereto are hereby overruled."

Thereupon the court entered its decree disapproving the plan of reorganization and dismissing the case.

In support of its motion that the court amend its said decree so as to grant the debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections, the debtor filed the affidavit of the debtor's president, setting forth (Rec., pp. 105 to 108):

That it was affiant's and the debtor's understanding and belief, until they had notice of the court's said decree, that in the event objections to said plan were sustained, time would be afforded the debtor to amend said plan or present an alternative plan calculated to meet and remove objections, and that such leave would be granted as part of the court's order;

that for this reason and no other the debtor did not make request, specifically, for such leave in the event of such disapproval; that under the provisions of the orders of reference to said Special Master, he was not authorized to entertain amendments or different plans, and it was not appropriate or proper that the same or either of them be presented to him in the absence of a further reference to him by the district court; that affiant verily believes that a plan of reorganization can be presented that will further the purposes and meet the requirements of the law and receive the approval of the district court; that if granted said leave, the debtor will propose a plan providing for extension of maturity of the mortgage trust deeds held by the debtor's two creditors until after the end of the present National Emergency, and for certain payments thereon in the meantime, (and containing other provisions as set forth more particularly in said affidavit); that unless the debtor is granted relief, it will suffer great and irreparable injury, and the result will be shockingly unjust to the debtor's stockholders; and that said decree was taken against the debtor through its inadvertance and excusable neglect and mistake.

The action of the district court upon the debtor's motion that the court amend its decree was as follows (Rec., p. 109):

"The motion to amend order entered September 12, 1941, having been submitted and fully considered, the court finds that upon the facts as presented to the court upon the Report of the Special Master (heretofore approved), no plan could be proposed which would be acceptable under the provisions of the Bankruptcy Act, and, therefore, it is ordered that the said

motion to amend order of September 12, 1941, be and the same is hereby denied."

The debtor appealed both from said decree or order issued Sept. 12, 1941, and from said order denying leave to amend.

Thus on this appeal, not only is the question presented whether the plan actually presented was and is fair and equitable and feasible, but the broader question whether a corporation in the financial plight of the appellant is entitled to any relief at all under Ch. X of the Bankruptcy Act.

ABUSES IN THE APPELLEE'S DESIGNATIONS OF RECORDS

1

The Designation of Record on Appeal filed by the appellee, runs counter to the provision of Rule 75(e) of the Rules of Civil Procedure, that "documents shall be abridged by omitting all . . . formal portions", by requiring the captions and verifications of all documents included in the record, notwithstanding by appellant's designation said portions were omitted.

2

The Designation of Record on Appeal filed by the appellee, runs counter to the provision of Rule 75(e), that "documents shall be abridged by omitting all irrelevant . . . portions", by requiring all documents included in the record to be set forth in full, notwithstanding by appellant's designation said portions were omitted.

3

Said Designation runs counter to the provisions of Rule 75(e), that "more than one copy of any document shall be

omitted", by requiring the inclusion in said record of the portions of the Special Master's Certificate and Report, consisting only of copies of documents included in said record by appellant's designation, and a copy of the transcript of certain of the testimony, notwithstanding the 8th specification in appellee's designation requires the inclusion in said record of said transcript in its entirety.

4

Said Designation runs counter to the provision of Rule 75(e), that "a party may prepare and file with his designation a condensed statement in narrative form of all or part of the testimony", and that "any other party to the appeal, if dissatisfied with the narrative statement, may require testimony in question and answer form to be substituted for all or part thereof", by requiring by said 8th specification the inclusion in said record of a complete transcript of the proceedings taken before the Special Master, including talk as well as testimony, in addition to appellant's condensed statement thereof in narrative form, notwithstanding appellee did not make any showing that it was dissatisfied with said narrative statement in any respect, nor designate for what portion of said narrative statement said question and answer form was to be substituted.

Said 8th specification, in requiring the designation in the record of talk as well as testimony, also runs counter to the well-known rules of practice on appeals, which may be summed up thus, following the 2nd Circuit: The complete stenographic report of all the talk in court should not be included in the record on appeal. The minutes of a referee should be limited to the substance of what is conceded by the parties and what

was actually decided or done. National Public Service Corp., CCA 2, Jan. 15, 1934, 68 Fed 2d 859.

In all the foregoing respects, the appellee's designation of record on appeal is within the remedial and penal provisions of Rule 75(e), as follows: "For any infraction of this rule or for the unnecessary substitution by one party of evidence in question and answer form for a fair narrative statement proposed by another, the appellate court may withhold or impose costs as the circumstances of the case and discouragement of like conduct in the future may require; and costs may be imposed upon offending attorneys or parties."

5

The Designation of Material under rule 19(6) of this court, filed by the appellee, runs counter to said rule, in that the appellee has caused unnecessary parts of the record to be printed, as follows:

The Restraining Order issued by the district court at the time of the filing of the debtor's petition (Rec., pp. 12 and 13);

The portion of the stenographic report of the Special Master's hearings set forth on pages 28 to 60 of the Record;

The portion thereof set forth on pages 79 to 97 thereof;

Certain administrative details of the debtor's plan of reorganization, not in question on this appeal, beginning with the 8th line of page 62 of the Record, and continuing to the bottom of page 63 thereof;

The statement of Special Master's Fees and Expenses, and of papers handed to the district court by him (Rec., pp. 98 to 100).

In this respect, the appellee's designation of material under rule 19(6) is within the remedial and penal provisions of

said rule, as follows: "If the appellee shall have caused unnecessary parts of the record to be printed, such order as to costs may be made as the court shall think proper.

ARGUMENT OF THE CASE

The argument of this case proceeds in four stages:

1st. That the answer of American Trust Company to the petition for corporate reorganization was filed too late, and the allegations of the petition, showing that the debtor is not insolvent in the absolute sense, must be deemed admitted for all the purposes of the case; that if the answer is not a nullity for this reason, the Special Master'sCertificate and Report is fatally defective in that it wholly fails to find upon the issues tendered by the answer.

2nd. That the finding of the Special Master that each and all the objections to the plan of reorganization, made by American Trust Company, are true, is erroneous for all the reasons set forth in the Specifications of Errors.

3rd. That on the contrary, the plan of reorganization is fair and equitable and feasible, within the meaning of the Bankruptcy Act and the decisions in pursuance thereof.

4th. That it was an abuse of discretion for the district court to refuse to grant the debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections.

1

In his only Certificate and Report, the Special Master sets forth: "Although there have been hearings on two different matters in connection with this debtor proceeding, as is shown in detail by the record herein, I am of the opinion that the

court can best deal with the pending questions on the basis of American Trust Company's prayer at the end of its objections 'that said plan of reorganization be disapproved and that the proceedings be dismissed or debtor adjudicated a bankrupt'. Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matters of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt."

Thus, there are no findings on the issues raised by American Trust Company's answer.

This omission may be justified and explained only on the ground that the Special Master and the district court deemed the answer a nullity, for the reason that it was not filed with the time allowed by the Bankruptcy Act.

Sec. 137 of the Act, 11 USC 537, provides that an answer controverting the allegations of a petition by or against a debtor may be filed by any creditor "prior to the first date set for the hearing provided in section 161 of the Act", 11 USC 561.

The first hearing date set by the district court for the hearing provided in said section, was April 7, 1941, the date set by the court in its order approving the debtor's petition as properly filed, for a hearing to determine whether or not the debtor should be continued in possession thereafter. The answer was not filed until April 14, 1941, 7 days thereafter, and 7 days after the time allowed therefor had expired: no extension of the time for answering was ever made or applied for.

In the event the answer is held to be a nullity, the allegations of the petition, showing that the debtor is not insolvent in the absolute sense, must be deemed admitted for all the purposes of the case.

In the event this court shall rule that said answer was not a nullity though not filed within the time allowed by law, the Special Master's Certificate and Report is fatally defective in that is wholly fails to find upon the issues tendered by the answer.

The Rules of Civil Procedure provide (53(a)): "The Master shall prepare a report upon the matters submitted to him by the order of reference, and, if required to make findings of fact and conclusions of law, he shall set them forth in the report"; and (52(a)): "In all actions tried upon the facts without a jury the court shall find the facts specially, and state separately its conclusions of law thereon and direct the entry of the appropriate judgment".

It is evident, as regards the issues tendered by the answer, the Special Master and the district court wholly failed to follow the requirements of the rules quoted, and for that reason the Certificate and Report of the Special Master, and the decree of the court, dated Sept. 12, 1941, are both fatally defective, and must be reversed.

2(a)

The appellant's exceptions 1 and 4 attack the Special Master's findings, affirmed by the district court, that the allegations of Objection 1 to the plan, that the debtor is insolvent, and of Objection 2, that the obligations due from the debtor to American Trust Company far exceed the value of the security, are true (Rec., pp. 100 and 101), on the ground

that said findings are contrary to the weight of evidence, and to American Trust Company's admissions resultant from its failure to answer within the time allowed by law.

The company's failure to answer in time has already been sufficiently considered: the point here is that said findings are contrary to the weight of evidence.

The evidence on which the Special Master relied to support this finding was that of the bank's assistant cashier that the amount owing it was $39,364.28; the testimony of two expert witnesses called by the bank that they had made a joint appraisal of the property subject to the bank's lien and that their appraisal thereof was $30,000 as the market value; and the Special Master's statement that an expert he had consulted had placed the same value upon it.

The Master's expert was not produced as a witness, and any further reference to him therefore need not be made.

Mr. Banker, one of the bank's experts, testified that in placing the price on the property, the bank's two experts had taken into consideration what the property might be sold for if subdivided and utilities put in; that in his opinion the property could not be subdivided and $30,000 gotten for it.

Mr. Thomas, the bank's other expert, agreed with Mr. Banker that a subdivision of the property would decrease its value because of the cost entailed in subdividing, the amount of available property, and the fact that revenue would be very limited in proportion to what could be obtained from bungalows or flats in Pacific Heights.

Mr. Thomas also testified that the Turk and Steiner corner adjoining the property in question had sold in September 1939 for $6,300, or about $1.10 per sq. ft., and that the Turk

and Fillmore corner adjoining had sold in August 1940 for $62,500, or about $6 per sq. ft, about 75 per cent of which would apply to the land.

Mr. Banker testified that in placing the price of 52 or 53 cents a sq. ft. on the property in question, they had considered the value of the adjoining Turk and Steiner corner, but not the adjoining Turk and Fillmore corner, because the latter was a piece of commercially leased business property with improvements, that paid over 10 per cent on the price it sold for. Mr. Thomas testified that the Turk and Fillmore corner was definitely not comparable, because Fillmore is a business street with some retail business on it, and the income from the improvements is perhaps $850 to $1,000 per month.

The condensed narrative of the testimony of Messrs. Thomas and Banker is set forth on pages 118 to 123 of the Record.

Mr. Bufford testified for the debtor that the foregoing sale of the Turk and Steiner corner was to Mr. L. R. Levin, that he built a gas station upon it at a cost of a little less than $8,000, and resold it to Mr. E. G. Kimball the fore part of 1940, that he had asked $18,000 for it, but had marked it up for trade-in purposes to $23,000 before selling to Mr. Kimball (Rec., p. 126).

It thus appears that after deducting the cost of the gas station, and allowing Mr. Levin a 10 per cent profit on the transaction, there remains on the 2nd sale of the Turk and Steiner corner a land value of over $8,000, or in excess of $1.40 per sq. ft.

The foregoing were all the recent sales of real property in the block in question.

Thus, turning from the opinion evidence to the factual, we have an actual land value on the Turk and Steiner corner of $1.40 per sq. ft., and on the Turk and Fillmore corner of $4.50 per sq. ft., at about the time of the filing of the petition herein. Both parcels immediately adjoin, for a distance of 85 feet or more, the property here in question.

It is well recognized that the most weighty evidence of the present value of land is price actually and contemporaneously obtained at actual cash sales of adjacent or near-by property.

Mr. Bufford also testified that the debtor had been offered $2,500 for its smaller parcel of land, a lot immediately adjoining the parcel subject to American Trust Company's lien. This offer amounts to $1.10 per sq. ft., or more than twice the figure quoted by the bank's two experts. Mr. Bufford further testified that the holder of the mortgage trust deed upon the smaller parcel had offered to take it in full of her demand of upwards of $3,500.

That the sum of $30,000, or 52 or 53 cents per sq. ft., stated by the two experts as their opinion of value, is far too low, is also apparent from other testimony Mr. Thomas gave. For he stated that the property in question is assessed by the City and County Assessor for $30,240, and the improvements thereon for $1,950 additional; that he has been associated with the Assessor for 10 years as advisory counsel; that the property in question is assessed proportionately (Rec., pp. 120 and 121). The court will take judicial notice that in San Francisco assessed value is about half of fair actual value.

It should also be noted that Mr. Thomas' and Mr. Banker's testimony respecting value of the property in question, after subdivision, referred only to value thereof subdivided but

vacant, and had nothing to do with its sale value subdivided and improved as provided in the debtor's plan of reorganization or in some other adequate manner.

There has not been one single sale of land in the entire block in which the property in question is located, at a figure anywhere near as low as that given by American Trust Company's expert witnesses. What sales there have been, have been at figures from twice to eight times as high.

It is evident that the Special Master's findings in question are not sustained by the weight of the evidence, and, besides, are contrary to American Trust Company's admissions.

2(b)

The appellant also excepted (Exceptions 2 and 6) to the following of the Special Master's findings, affirmed by the district court, on the ground that they are not supported by evidence, and are contrary to the express provisions of the proposed plan of reorganization.

a. The finding that the allegation that the plan contemplates the realization of something by the debtor at American Trust Company's expense, in Objection 1 to the plan, is true:

b. The finding that Objection 4 to the plan, that said plan provides for scaling down American Trust Company's demand, is true.

As heretofore summarized (and see Rec., pp. 61 to 75, for the plan in full), the plan provides for the issuance to American Trust Company of a new mortgage trust deed for the entire principal of its demand and of all cash advances, and for the issuance to it of preferred capital stock of the debtor, with absolute priority, for the residue of its demand, mostly unpaid interest. Thus the plan provides for payment of Ameri-

can Trust Company in full before the debtor realizes anything at all, and does not scale down American Trust Company's demand in the least.

There is no evidence in the record to the contrary, and none to support these findings.

Even were the findings that the plan contemplates the realization of something by the debtor, and for the scaling down of American Trust Company's demand, supported by evidence, no valid objection to the plan could be based thereon. The very purpose of Ch. X is to make possible the realization of something by a debtor, and in the accomplishment of that purpose, to scale down the creditor's demand. The supreme Court expressly so holds.

In City Bank vs. Irving Trust, Jan. 4, 1937, 299 U. S. 433, 438-439, 57 S. C. 292, 81 L. 324, it declared: "The purpose of sec. 77B was to facilitate rehabilitation of embarrassed corporations by a scaling or rearrangement of their obligations and stockholders' interests, thus avoiding winding up, a sale of assets, and a distribution of the proceeds. A salient element in such a reorganization is the discharge of all demands of whatsoever sort, executory or contingent, presently due or to mature in the future."

In Kuehner v. Irving Trust, Jan. 4, 1937, 299 U. S. 445, 452, 57 S. C. 298, 81 L. 340, the Supreme Court added: "While the 5th Amendment forbids the destruction of a contract, it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable and equitable distribution of those assets."

In sustaining the constitutionality of the Agricultural Adjustment provisions of the Bankruptcy Act, sec. 75, 11 USC 203, known as the 2nd Frazier-Lemke Act, and the action of a district court in scaling down a farmer's indebtedness to the value of the mortgaged property, the Supreme Court, reversing 3 Courts of Appeals and overruling 14 other decisions of lower courts, said: "The mortgagor is in default, but it is not therefore to be assumed that he is a wrongdoer, or incompetent to conduct farming operations. The legislation is designed to aid victims of the general economic depression." The court added: "The farmer's proceeding in bankruptcy for rehabilitation, resembles that of a corporation for reorganization." Wright v. Vinton Branch, Mch. 29, 1937, 300 U. S. 440, 466, 467, 57 S. C. 556, 81 L. 736.

2(c)

Likewise the debtor excepted (Exceptions 5) to the Special Master's finding, affirmed by the district court, that the allegations of Objection 3 are true, on the ground that said finding is not supported by evidence, and is contrary to the express provisions of said plan. This Objection is that the plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel in proposing to deed it to her in full settlement of her demand.

But the undisputed evidence is that her demand amounts to about $1.60 per sq. ft. of land held by her as security, whereas the demand of American Trust Company is less than 75c per sq. ft.; that the two parcels adjoin each other in the same block; that both are inside parcels; and that her parcel does not fit into the plan of reorganization proposed by the debtor.

If American Trust Company thought the plan was wrong in

this respect, it had the right to propose modification of the plan, but it did not, limiting itself to mere obstruction.

Besides, sec. 216 of the Act, 11 USC 616, subd. (2), expressly provides that a plan of reorganization "may deal with all or any part" of the debtor's property; and subd. (3) of that section expressly empowers the judge to authorize the debtor in possession to sell any property of the debtor on such terms and conditions as the judge may approve.

Moreover, the objection if valid, goes only to a minor detail of the plan; and if sustained, could and should be remedied by amendment of the plan, and is not sufficient ground for rejection of the plan.

2(d)

The debtor excepted (Exceptions 7 and 8) to the Special Master's finding, affirmed by the district court, that American Trust Company's 5th Objection to the plan is true, on the ground that said finding is not supported by evidence, is directly contrary to the only evidence in the record touching the matter, and is contrary to the express provisions of the plan. The Objection in question is that the plan contemplates that the assets of the debtor be used in a speculative venture for which there is no reasonable prospect of success.

At the outset, there is to this Objection the conclusive answer that out of the sale price of each of the proposed 23 dwellings to be erected on the property in question pursuant to the plan, American Trust Company is given an absolute preference to the extent of the pro rata of its new mortgage on the parcel occupied by the dwelling sold,—an amount equal to the exact total of principal of its loan and advances, and, according to

the testimony of its expert witnesses, substantially as much as it can get by a sale of the land in its present condition.

It is also to be noted that there is no testimony in the record to the effect that the plan involves a speculative venture, nor that it has no reasonable prospect of success.

To the contrary, is the testimony of Mr. Thomas, one of the expert witnesses called by American Trust Company, explaining the greater relative value of the adjoining Fillmore-Turk corner, as due to its being improved with stores and a hotel upstairs, though old (Rec., p. 120); and of Mr. Bufford, the debtor's president, stating the increase in sale price of the adjoining Steiner-Turk corner, when improved with a gas station (Rec., pp. 126 and 127).

This testimony is very persuasive that the property in question, if suitably improved, will sell readily for far more than American Trust Company's experts now value it at.

Mr. Bufford also gave testimony, wholly unquestioned, in support of the soundness, from every point of view, of the building program proposed in the plan of reorganization. (Rec., p. 128 to 132.)

He testified that lots improved as outlined in the plan, will have a land value of $2,000, and, with improvements costing not to exceed $7,500, will sell for about $10,000 per lot.

He also testified that he was informed by the engineer's office in the City Hall that a 26-foot pavement for the proposed street was satisfactory.

He further testified: Across the street from the proposed development, there is a row of flats. Next door to it, there are two flats. To the east, from Fillmore to Webster, there are a number of apartment houses of various sizes. And there are

other residences in the vicinity, both on Eddy and Turk Streets. A modernization program is going on, as regards the flats across the street from the proposed development. In the last 6 months the flats immediately to the west of the property in question have been modernized. The demand for residential accommodations in the district is very good. There are very few vacancies in the neighborhood,—less than 10 per cent.

Thus the proposed plan is no more speculative in nature than the construction of any building in any thickly populated district, wherein there is a constant demand for all available buildings of the type proposed.

If this plan can be rejected on this ground, it means that no subdivider can successfully propose a plan of reorganization which involves a building program.

This very objection has been definitely overruled in several cases.

In New Rochelle, CCA 2, June 3, 1938, 77 Fed. 2d 881, it was argued that the plan there involved was unfair because "there should be some guaranty that by the end of 3 years the creditors would be paid without question." The court answered, p. 883, "Nothing in the statute requires such a guaranty in a plan of reorganization."

The 7th Circuit court, answering an objection that the plan there proposed was not feasible in that it was dependent for success upon future economic conditions, said: "What the property is, and what it has produced, is well known. What it will do in the future is, of course, problematical. Under existing conditions no one can say with assurance that the plan will succeed. The district court thought that immediate liquidation would be disastrous to all interests and that there was

reasonable ground for believing that the plan would succeed. We concur in that view." 333 N. Michigan Ave., CCA 7, July 1, 1936, rh. dn. July 24, 1936, 84 Fed. 2d 936.

A district court very recently took the same view. In approving, over bondholders' objections, a plan of reorganization of a small company, it pointed out, in answer to certain objections, that without the plan the bondholders' investment was worth about 30 cents on each dollar invested; that under the stock and bond provisions of the plan, if their stock should be ultimately called, they would get 40 cents on the dollar, plus dividends from Jan. 1, 1943, until called. Central Forging, Dist. Ct. Pa., Apr. 15, 1941, 38 FS 18.

Far from the proposed plan of reorganization being a speculative venture without reasonable prospect of success, it assures American Trust Company of as much as its expert witnesses assert it can get out of the property in its present condition, affords reasonable basis for belief that it will realize all the remainder of its demand, and offers the debtor's stockholders a reasonable opportunity to realize on their equity in the land.

It is clear from the cases cited, that to warrant approval of a plan, absolute certainty of success is not requisite.

Besides, it appears in the evidence that the debtor's old dwelling-houses, such as they are, now on its property, are continuously occupied; that there is an unsatisfied demand for residential quarters in the neighborhood in question; and that the property in question, by reason of size and location, is peculiarly well suited for the development proposed by the plan of reorganization.

It is also to be noted: On the property in question as it now stands, there are no corner lots: it is all inside property: the

plan will have the additional advantage of creating 4 corner lots: this factor alone will add much value.

2(e)

The debtor also excepts to the Special Master's findings, affirmed by the district court, that the debtor is insolvent and that its obligations to American Trust Company far exceed the value of the security, on the ground that these findings deal with matters outside the issues in the case, and that the objections of American Trust Company to the plan of reorganization, based on these propositions, are without force or validity.

In Dollar Dry Cleaning, Dist. Ct. Conn., June 21, 1940, 33 FS 861, the court pointed out that the transcript of the hearing before the referee showed clearly that the referee's recommendation of liquidation was predicated upon the debtor's insolvency. The court held: "The question of insolvency was not directly in issue before the referee. Instead the true issue under Ch. X was whether or not the interests of the creditors and stockholders required an adjudication, or a dismissal instead."

The decisions in the 2nd Circuit demonstrate that insolvency is a false issue in reorganization proceedings. In Central Funding, CCA 2, Feb. 11, 1935, 75 Fed. 2d 256, the court overruled the objection to a plan of reorganization under sec. 77B that an insolvent debtor could not reorganize under that section. In New Rochelle, CCA 2, June 3, 1935, 77 Fed. 2d 881, the court overruled the contrary objection that a solvent company was not entitled to reorganize under sec. 77B.

With respect to farmer-debtors, the Supreme Court in John Hancock Ins. Co. v. Bartels, Dec. 4, 1939, 308 U. S. 180, 184-185, 60 S. C. 221, 84 L. 176, declared: "The plain purpose of sec. 75 was to afford relief to such debtors who found them-

selves in economic distress however severe", and affirmed the action of the 5th Circuit in directing a district court to reinstate a farmer-debtor's petition under sec. 75, which the district court had dismissed.

In another case, the Supreme Court reversed a district court's dismissal of an insolvent irrigation-district's plan of composition, stating, "As the bankruptcy power may be exerted to give effect to a plan for the composition of the debts of an insolvent debtor, we find no merit in appellant's objections under the 5th Amendment." U. S. v. Bekins, Apr. 25, 1938, 304 U. S. 27, 54, 58 S. C. 811, 82 L. 1137.

And, in reversing the confirmation by a district court of a plan of reorganization of a corporation with secured claims amounting to $3,800,000 and total assets not exceeding $900,000, in answer to the contention that if the district court was reversed, the stockholders would lose everything, the Supreme Court declared, "Failure to accept this plan does not force dismissal or liquidation . . . In this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted". Case v. Los Angeles Lumber, Nov. 6, 1939, 308 U. S. 106, 131-132, 60 S. C. 1, 84 L. 22.

Thus, a plan of reorganization may be worked out by a corporation, although hopelessly insolvent.

2(f)

The debtor also excepted (Exception 3) to the Special Master's finding, affirmed by the district court, that American Trust Company's objection to the plan, that it contemplates the creation of a prior encumbrance upon the property, is true, on the ground that this finding deals with a matter outside the

issues in the case, and that the objection to the plan, based on this finding, is without force or validity.

The prior encumbrance authorized by the plan, is the issuance of noninterest-bearing certificates of indebtedness to the amount of the actual value of labor and materials furnished to be used and actually used on the property in its development for residential purposes and the construction thereon of the proposed duplex dwellings; and the amount of this proposed prior encumbrance is to be no greater than the value thereby added to the security.

The creation of a prior encumbrance to secure these advances is in exact conformity with sec. 116(2) of the Act, 11 USC 516(2), which provides, "The judge may authorize certificates of indebtedness for cash, property, or other consideration, upon such terms and conditions and with such security and priority in payment over existing obligations, secured and unsecured, as in the particular case may be equitable."

That new money and property furnished, may equitably be given priority over old money is an age-old principle of admiralty law, also applicable in other fields of law, with which this court is familiar.

2(g)

The debtor's exceptions 9 and 10 attack the ruling of the Special Master, affirmed by the district court, that the only question before him was the value of the property in question at the time of his hearing, in its then present condition, and his refusal to consider its value were the plan of reorganization carried out.

The debtor's contention is that the relevant inquiry is the value of the property if the plan is carried out.

In Reb Holding Co., Dist. Ct. Wis., Nov. 19, 1940, 35 FS 716, the court overruled a Special Master who took a view similar to that of the Special Master here. In rejecting the Master's report against a plan of reorganization, and upping the valuation the Master put on the property there involved, the court declared, p. 717: In determining valuation of property of the debtor in corporate reorganization proceedings, "no one valuation should be used exclusively in arriving at a fair valuation. By using the various methods, any inaccuracy which might be inherent in one method, can be eliminated. It is the purpose of Ch. X to conserve, if possible, the full value of the property for junior creditors and for the debtor, as well as for the creditors who might have priority."

Another district court, in upping the valuation placed upon Cuban bonds by a Special Master to the extent of $3,873,635, after mentioning older ideas of value, said: "There is, however, a noticeable present tendency not to be bound by instant market prices, but to look into the future, to a proper extent, in appraising the value of property . . . This tendency should be especially applicable to valuations under sec. 77B. It is well settled that the words 'fair value' need not mean liquidating value, nor need they be regarded in law as equivalent to present realizable value . . . And especially is this true when one considers that the purpose of sec. 77B is to enable corporations in financial difficulties to readjust their indebtedness and continue in business without a forced liquidation of their assets." Warren Bros. Co., Dist Ct. Mass., May 26, 1941, 39 FS 381, 384.

The Supreme Court has also had occasion to take a similar view of the problem. In reversing the confirmation by a district court of a plan of reorganization, and remanding the cause for further proceedings, it pointed out the necessity of seeking to value the enterprise in question by a capitalization of future earnings, and added, "Findings as to the earning capacity of an enterprise are essential to determination of the feasibility as well as the fairness of a plan of reorganization." Consol. Rock Products v. Du Bois, Mch. 3, 1941, 312 U. S. 510, 525, 61 S. C. 675, 85 L. 982.

It is evident that in passing upon a plan of reorganization the court must consider "going-concern" values and not "liquidation" value,—value in the event the plan is adopted, not value in the company's embarrassed condition.

Is is obvious that the value of the present debtor's property in its present state, in part unoccupied and in part inadequately occupied, and in consequence returning insufficient revenues to cover carrying charges or give a return on the investment, is far less than that value would be, were the property subjected to a comprehensive plan of improvement, reasonably calculated to bring in an adequate return on a larger valuation.

There was testimony before the Special Master definitely showing that if the debtor's plan was carried out, the value of the property would be greatly enhanced: the Master erred in refusing to consider such testimony in arriving at value.

3(a)

Turning from the Objections to the plan of reorganization, none of which may properly be deemed of merit, and from errors of the district court in other respects, I urge affirmatively

that the plan complies with all statutory requirements, and with all court decisions, as to fairness and equitableness, and fully qualifies as a lawful and appropriate plan.

The plan renews American Trust Company's mortgage trust deed for the principal thereof and cash advances thereunder, amounting to $29,755.31; and gives American Trust Company preferred capital stock of the debtor, with absolute priority, to the amount of other sums due it.

In Case v. Los Angeles Lumber, Nov. 6, 1939, 308 U. S. 106, 60 S. C. 1, 84 L. 22, wherein a plant was set aside as not fair and equitable, the debtor was a holding company; the bondholders' lien covered the capital stock owned by the debtor in all its subsidiaries; the bondholders' claims amount to $3,800,000; assets did not exceed $900,000, considerably over $800,000 of which were subject to the bondholders' lien; the proposed plan gave the bondholders preferred stock with absolute priority in lieu of their bonds, but only in the amount of $641,375, or 77 per cent of the value of the security, and turned the other 23 per cent of the security over to the stockholders.

Similarly in Chapman Bros. v. Security-1st Bank, CCA 9, Apr. 10, 1940, 111 Fed. 2d 86, where this court set aside a plan as not fair and equitable, it was objectionable for the same reason as the plan in Case v. Los Angeles Lumber: it required a secured creditor to share his inadequate security with an insolvent debtor.

The plan here, however, is free from these objections. It not only gives American Trust Company absolute priority to the full extent of its entire demand, but, through the preferred stock provisions of the plan, extends to it preferred participa-

tion in the general assets of the debtor, as well as in its security, if needful to the liquidation of its demand.

In Consol. Rock Products v. Du Bois, Mch. 3, 1941, 312 U. S. 510, 61 S. C. 675, 85 L. 982, wherein a plan was set aside, the debtor had intermingled the assets of 2 wholly owned subsidiaries with its own, and besides owed the subsidiaries large sums of moneys; and the court held that in the absence of findings as to the values of the respective interests of the 3 companies in the assets, and as to the state of accounts between them, a court was not in a position to determine the fairness and equitableness of a plan of reorganization as between the 2 sets of bondholders of the 2 subsidiaries and other interested parties.

In concluding its discussion, the court declared in the latter case, pp. 528 and 529 of 312 U. S.: "The absolute priority rule does not mean that bondholders cannot be given inferior grades of securities or even securities of the same grade as are received by junior interests. Requirements of feasibility of reorganization plans frequently necessitate it in the interests of simple and more conservative capital structures . . . While creditors may be given inferior grades of securities, their 'superior rights' must be recognized . . . Practical adjustments, rather than rigid formula, are necessary. The method of effecting full compensation for senior claimants will vary from case to case."

Intermediate the 2 Supreme Court decisions last considered, in a case of great magnitude, the Supreme Court denied certiorari from a decree of the 2nd Circuit, whereby a plan of reorganization conformable to the last quoted statement of the Supreme Court had been approved. The Court of Appeals

held that want of fairness and equitableness in the plan there before it could not be predicated upon issuance to creditors of prior preferred stock in lieu of bonds secured by a trust deed, and approved a plan so providing. Radio-Keith-Orpheum, CCA 2, July 18, 1939, 106 Fed. 2d 22, cert. dn. Jan. 2, 1940, Cassel v. R-K-O and Stirn v. Atlas, 308 U. S. 622, 60 S. C. 380, 84 L. 520, rh. dn. Feb. 5, 1940, 309 U. S. 694, 60 S. C. 512, 84 L. 1035.

The plan in this case goes beyond the requirements of Radio-Keith-Orpheum, last cited.

Indeed, it was recognized in Kuehner v. Irving Trust, Jan. 4, 1937, 299 U. S. 445, 451-452, 57 S. C. 298, 81 L. 340, that while a secured creditor's security cannot be diverted from its function of securing his demand, his demand may nevertheless be scaled down.

The court declared: "There is, as respects the exertion of the bankruptcy power, a significant difference between a property interest and a contract, since the Constitution does not forbid impairment of the obligation of the latter. The equitable distribution of the bankrupt's assets, or the equitable adjustment of creditors' claims in respect to those assets, by way of reorganization, may therefore be regulated by a bankruptcy law which impairs the obligation of the debtor's contracts. Indeed, every bankruptcy act avowedly works such impairment. While, therefore, the 5th Amendment forbids the destruction of a contract, it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable and equitable distribution of those assets."

District courts, accordingly, have approved plans scaling down secured creditors' demands. Central Forging, Dist. Ct. Pa., Apr. 15, 1941, 38 FS 18.

The plan is not only completely within the limits of fairness and equitableness as defined in the decisions, but every provision of the plan is specifically authorized by express provisions of Ch. X.

Sec. 116(2) of the Act, 11 USC 516(2), expressly provides that the judge may authorize certificates of indebtedness for property, with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable. The plan so provides, with proper and adequate safeguards to protect the interests of all concerned.

The other provisions of the plan are exactly within the authorization of subsection 216(10), 11 USC 616(10), of the Act, which provides that a plan may include: The retention by the debtor of all or any part of its property; the sale of all or any part of its property, subject to or free from any lien, at not less than a fair upset price, and the distribution of all or any assets or the proceeds of the sale to those having an interest therein; the curing or waiver of defaults; the extension of maturity dates; changes in interest rates; the amendment of the debtor's charter.

3(b)

The plan is feasible, proposing a workable plan for the utilization of the debtor's property, in the course of the execution of which it is reasonable to expect that sufficient returns will be realized to liquidate American Trust Company's entire demand and also give some return, over and above that, to the debtor's stockholders.

There is nothing for which there is a more constant demand in any great city than for good dwellings. Every thickly settled neighborhood has a type suited thereto; and where, as in the neighborhood here in question, existing dwellings are almost fully occupied, there is evident room for new construction of a proper type. The building industry is so far standardized that costs of construction, dependent on type and elegance, can be accurately estimated in advance, eliminating speculative factors. No enterprise, more substantial, nor with greater certainty of success, could be found than the building program proposed in the plan; nor one that promotes a more fundamental policy of the national government.

The evidence on this point, as well as applicable decisions, have already been reviewed quite fully in section 2(d) of the argument of this brief, dealing with the objection that the plan calls for a speculative venture.

It cannot be doubted that the plan is feasible: yet on this fundamental question neither the Special Master, nor the district court, made any findings. This alone is reversible error.

4

It was an abuse of discretion, and hence reversible error, for the district court to refuse to amend its decree disapproving the debtor's plan of reorganization and dismissing the proceedings, so as to grant the debtor leave to amend the plan or to present an alternative plan calculated to meet and remove objections.

At the time the decree was issued, only one plan had been proposed, and no opportunity had been given, at any stage of the proceedings, to amend the same.

By the terms of the reference to the Special Master, he was limited to a consideration of the issues raised by the objections of American Trust Company to the plan, and by those objection no question respecting the amendment of the plan was raised, but its entire rejection was demanded.

The Special Master had no power to consider any matter outside the terms of the order of reference: thus the debtor could not move him for leave to amend.

Nor was it desirable or appropriate for the debtor to move the district court for leave to amend its plan before it had passed on the debtor's exceptions to the Certificate and Report of the Special Master. And as the district court passed upon those exceptions as part of its decree, it is evident that the debtor was not, at any stage of the proceedings, afforded any opportunity to amend its plan.

The analogies afforded by the Rules of Civil Procedure indicate that it was reversible error for the district court to fail to grant the debtor the leave in question. For sec. 15(a) as to amendments to pleadings, after stating that after a responsive pleading or the lapse of 20 days, a party may amend a pleading only by leave of court or written consent of the adverse party, adds, "Leave shall be freely given where justice so requires."

It is evident that in this case "justice so requires"; for if the leave is not granted the purposes of Ch. X will be defeated insofar as the debtor is concerned.

In introducing the Act into the House, Representative Chandler said: "The theory now is to conserve rather than liquidate the estate, give the debtor a chance to work out his financial difficulties and not destroy his business . . . It means that when financial evil days come upon one, he may seek the aid

of the bankruptcy court of the United States, and by this method may keep his creditors at bay until he has time to regain his financial equilibrium." Cong. Rec. House, Aug. 10, 1937, 75th Cong. 1st Sess., p. 8649.

In introducing the Act into the Senate after passage by the House, Senator O'Mahoney said: "If I were to describe this bill in a single line, it would be 'a measure fashioned to promote rehabilitation of business rather than liquidation.' " Cong. Rec. Sen., June 10, 1938, 75th Cong. 3rd Sess. p. 8679.

In similar vein, in one of the earliest cases to come before a Court of Appeals, respecting corporate reorganizations, the 2nd Circuit said: "The apparent purpose of sec. 77B of the Bankruptcy Act, 11 USC 207, which provides for proceedings in the reorganization of a corporation and its subsidiaries, is to avoid immediate liquidation of the properties involved, and to rehabilitate rather than liquidate." Greyling Realty Corp., CCA 2, Jan. 7, 1935, 74 Fed. 2d 734, 736, cert. dn. Apr. 1, 1935. Troutman v. Compton, 294 U. S. 725, 55 S. C. 639, 79 L 1256.

Similarly the 8th Circuit, in affirming an order refusing bondholders the right to foreclose on a hotel, declared that the evidence conclusively showed that at the time of the district court's order there was no market whatever for the hotel, and added: "So it is not difficult to see that if sold now, no one except appellant could be or would be a bidder at such sale, and an unnecessary sacrifice of value would occur, with the result that the deficiency to be allowed in favor of appellant as a general creditor would be shockingly unjust to the estate and to other unsecured creditors, as also to the holders of bonds secured by the second mortgage." Central States Life v. Koplar Co., CCA 8, Dec. 17, 1935, rh. dn. Feb. 5, 1936, 80 Fed. 2d 754, 760.

The Supreme Court has emphasized that courts must construe liberally the provisions of the Act respecting reorganizations with a view to effectuating their purpose.

In rejecting a construction of Ch. X which would bar a landlord's right to prove a contingent claim in a reorganization proceeding, it declared: "Such a construction would ill accord with the remedial purposes of the Act, which demand a liberal construction in favor of the claimants for whom relief is intended." City Bank v. Irving Trust, Jan. 4, 1937, 299 U. S. 433, 444, 57 S. C. 292, 81 L. 324.

In sustaining the provisions of the 2nd Frazier-Lemke Act for extension of the time of redemption from sales in pursuance of mortgage contracts, it said: "The development of bankruptcy legislation has been towards relieving the honest debtor from oppressive indebtedness and permitting him to start afresh. By the Act of March 3, 1933, the Congress deliberately undertook the rehabilitation of the debtor as well as his discharge from indebtedness . . . This legislation for rehabilitation has been upheld as within the subject of bankruptcies." Wright v. Union Central Life, May 31, 1938, 304 U. S. 502, 514, 58 S. C. 1025, 82 L. 1490.

In affirming the action of the 5th Circuit in directing a district court to reinstate a farmer's petition under sec. 75 of the Act, 11 USC 203, which the district court had dismissed, it said: "The subsections of sec. 75 which regulate the procedure in relation to the effort of a farmer-debtor to obtain a composition or extension, contain no provision for a dismissal because of the absence of reasonable probability of the financial rehabilitation of the debtor. Nor is there anything in these subsections which warrants the imputation of lack of good faith to a

farmer-debtor because of that plight. The plain purpose of sec. 75 was to afford relief to such debtors who found themselves in economic distress however severe, by giving them a chance to seek an agreement with their creditors (subsections (a) to (r)), and, failing this, to ask for other relief afforded by section (s)." John Hancock Ins. Co. v. Bartels, Dec. 4, 1939, 308 U. S. 180, 184-185, 60 S. C. 221, 84 L. 176.

What is more, the Supreme Court views the right to present an amended or different plan as one that still exists after reversal of an order of a district court confirming an earlier plan. For in reversing a previous confirmation of a plan, the Supreme Court, in answer to the suggestion that were the district court reversed the stockholders would lose everything, declared that the right to present an amended or different plan would still exist after the reversal. It said: "Failure to accept this plan does not force dismissal or liquidation. Sec. 77B(c) (8), 11 USC 207(c) (8), gives explicit powers where 'a plan of reorganization is not proposed or accepted within such reasonable time as the judge may fix' either to 'extend such period' or to 'dismiss the proceeding', or, with exceptions not relevant here, to cause liquidation, such choice to be made 'as the interests of the creditors and stockholders may equitably require'. Accordingly, dismissal has not infrequently been properly denied. Bush Terminals, CCA 2, July 6, 1936, 84 Fed. 2d 984. And in this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted nor that all reasonable time for proposal of such alternative plan has expired." Case v. Los Angeles Lumber, Nov. 6, 1939, 308 U. S. 106, 131-132, 60 S. C. 1, 84 L. 22. (The provision of sec. 77B

referred to and quoted in this decision is now incorporated into sec. 236 of the Act, 11 USC 636.)

In Bush Terminals, cited with approval by the Supreme Court in the foregoing quotation from Case v. Los Angeles Lumber, the 2nd Circuit, in reversing at the instance of certain creditors and stockholders a dismissal of a reorganization proceeding at the debtor's request, pointed out that it was plain the debtor could not meet his obligations in the usual course of business were certain disputed claims found valid, and instructed the district court to adjudicate those claims; thereupon consider the proposed plan of reorganization as well as any amended or further plan presented within such time as the court might deem reasonable; then if none of them were adopted, dispose of the property of the debtor or the proceeds thereof in such way as will adequately protect all creditors; or, in the event creditors were satisfied, turn over the property to the debtor. Bush Terminals, CCA 2, July 6, 1936, 84 Fed. 2d 984.

Indeed, with respect to plans of reorganization, the 7th Circuit is of opinion that a district court is charged with the affirmative duty of taking the initiative needful to secure an equitable and feasible plan. In a proceeding by an individual, under sec. 74 of the Act, 11 USC 202, for a composition or extension of time, the 7th Court, in affirming the action of a district court refusing to vacate an order restraining the foreclosure of a mortgage, the mortgagee being the bankrupt's sole creditor, said: "We may add, success under this Act will not be assured, unless the court recognizes that its duties are primarily administrative. It must act as the head of the administrative branch of an enterprise. It cannot sit idly by and act

on plans submitted. It must originate, if necessary, and in many cases use all the forces at its command to bring about cooperation between conflicting interests. It may have to remove officers by it appointed if plans and recommendations are not presented within a reasonable time." M. M. Sterba, CCA 7, Jan. 5, 1935, 74 Fed. 2d 413.

It is evident that the district court's refusal to grant the debtor leave to amend the plan or to present an alternative plan was reversible error, and that its dismissal of the proceedings was premature, especially in view of the debtor's expressed willingness in its affidavit in support of its motion for said leave to propose and accept a plan substantially identical in form with the farmer's legislative plan of reorganization under the 2nd Frazier-Lemke Act, approved as against all objections in Wright v. Vinton Branch, Mch. 29, 1937, 300 U. S. 440, 57 S. C. 556, 81 L. 736.

CONCLUSION

It thus appears:

1st. That none of the objections to the proposed plan of reorganization is sound;

2nd. That it meets all requirements as to fairness and equitableness and feasibility;

3rd. That Ch. X is entitled Reorganizations; its purpose is to promote them; the policy of the Act is that all parties shall co-operate in formulating them and making them effective; it is the duty of a district court to act affirmatively to that end;

4th. That the district court erred not only in disapproving the proposed plan, but, beyond that, in refusing leave to amend the same or to present a different plan, thus in effect denying

the debtor the relief contemplated by Ch. X, and so far as it is concerned, erasing the Act from the statute books.

It follows that the decree and order appealed from should be reversed, with instructions to the district court to take proceedings in the case not inconsistent with the decision of this court.

San Francisco, Calif., January 20, 1942.

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